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China's Reemergence and Role in World Trade

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President Xu, distinguished guests and friends, thank you very much. I am pleased to be here with you today, in this historic setting and at this very interesting moment in history, to help mark the opening of the 2006 Beijing Forum.

The theme of this Forum is “The Harmony of Civilizations and Prosperity for All—Reflections on the Civilization Modes of Humankind.” Nearly five years ago, China formally joined the WTO, and since then its economic reemergence has reshaped the world. These events have fundamental implications for world prosperity and harmony among civilizations, and so this is a timely and important theme.

Since China joined the WTO, we have seen China's economic development broaden and deepen, so that China is again, as it was in the early 1800s, a pillar of the international trading system. One snapshot tells this story: in 1999, when the US-China WTO agreements were concluded, China reported about \$360 billion in total global trade. By 2005 the figure was \$1.4 trillion, and this year's will approach \$1.7 trillion—nearly 5 times as high. In 1999, China accounted for about four percent of world trade; today, its share is approaching ten percent.

And as China's development has continued and China has become a major world economy, we see changed patterns in China's economic engagement with the world. For instance:

- Chinese businesses are now overseas investors as well as partners and seekers of FDI within China;
- China's Central Bank is an influential actor in global finance and currency markets;
- Chinese science, entertainment and engineering aspire to create, as well as to assemble innovative and technology-intensive products.

China's development and commercial success, and its expanded role in the world, should be welcomed. China's trade boom supports economic growth around the world, reduces poverty in China, strengthens China's relationships, and ultimately helps foster a stronger peace. Indeed, these outcomes are consistent with the basic principles of the world trading system and the vision set forth by its founders including China 60 years ago.

But because the pace of integration is so rapid, and because China is so large, integration is a disruptive as well as a beneficial event. Modern economic history offers few parallels if any exist for such a massive and rapid rise. Some of its ripple effects relate to the relationships between China and its individual or regional trading partners; some relate to macroeconomic issues that affect the global economy as a whole. Governments can let them pass, under the risky assumption that they will work out over time. Or governments can become belligerent, playing to political and more nationalistic audiences. Or, they can try to cooperate in easing the frictions, tensions and imbalances that have emerged, as I hope they will.

Before I turn to several of the effects of China's global integration, it is useful to provide some context to the trade environment in which the major global players operate.

Context For Discussion

The WTO in particular, but also the IMF, the World Bank, and other organizations, are the modern incarnation of the liberal economic internationalism that developed after the Second World War. The Allied leaders had lived through the general rush to national self-reliance at the beginning of the Depression in the late 1920s, and the resulting collapse of trade—from \$68 billion in 1928, to \$24 billion in 1932. The world fragmented into something like a series of island economies, within just a few years. Attempts to find cooperative solutions failed. The economic experience was the backdrop to the rising political tension and radical nationalism of the 1930s.

The modern trading system is the result of this experience. Opening the first international trade talks in 1945, U. S. President Roosevelt set two goals for the project:

—To create shared opportunities for growth, consistent with broadly accepted economic theory, through negotiations to open markets and create rules that would help keep markets open during crisis; and

—To give nations a greater stake in one another's stability and prosperity, and in so doing, as he put it, to "lay the economic basis for the secure and peaceful world we all desire."

This has proceeded over 60 years across 12 multilateral agreements, punctuated by the first agreement in 1947, the creation of the WTO in 1994, and China's entry five years ago. The result, more or less, is what Roosevelt was hoping to see.

WTO rules now cover all but one of the world's great powers, Russia, and about 97 percent of global trade. Markets are much more open as a result. When this building, the Great Hall of the People, opened in 1959, exports made up about 2.5 percent of global GDP, and now they total well above 20 percent; and when inevitable disputes emerge, they can be handled by WTO panels under accepted rules.

The system has some big gaps, of course. Some are policy-related. Existing farm trade agreements are weak, and the WTO's Doha talks are stalemated over the difficulty of improving them. Existing WTO services trade agreements are largely a reflection of the status quo, and still early in their development. Even more important, much of the Muslim world remains outside the global trading system, creating dangers that I will discuss later.

That said, in tandem with other factors—for example, medical advances, the waning of ideological conflict and urbanization—most countries are considerably wealthier. Conflict among big powers has become rare. The major economies do their best to live within the rules they have written for themselves; and the general commitment to an open world economy is the framework in which China and its trading partners will work out their differences.

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With this background, let me now turn to some of the ripple effects of China's economic reemergence and the issues that the world's major economies, and particularly China and the United States, will need to manage within the context that I have just described.

New Regional Patterns

First, China's economic growth has remade the Asian economic map, reshaping a 50-year-old pattern of Pacific trade and investment centered on exports to the United States. This new pattern needs to be understood and properly managed by policymakers.

After the Second World War, most of China's neighbors developed by exporting manufactured goods to the United States. Japan rose first, then Korea, Hong Kong, Singapore and Taiwan, like geese flying in formation; then the middle-sized ASEAN states. In effect, Asian development rested upon FDI from Japan, and then from the newly industrializing countries ("NICs"), plus an economically receptive American market.

This pattern endured until roughly the time China joined the WTO; it is now changing. China's opening, beginning with domestic economic reform and then accelerated by the implementation of WTO commitments, has sparked a wave of Asian investment in the mainland: Japan, Korea, Taiwan, Hong Kong and Singapore combine each year to invest \$40—\$50 billion in FDI in China. This FDI, said to put up fifteen thousand or more manufacturing facilities' annually, has very quickly combined the financial and technological strengths of China's neighbors with China's own relatively low costs, large manpower reserves, and excellent trade infrastructure.

In a historical sense, you could say that this pattern reflects a variant of the pre-colonial China-centered Asia. Today, China is the productive center; Japan and the tigers' are suppliers of capital and technology; and the ASEAN countries, Siberia and to an extent the world are raw-materials suppliers. More prosaically, China is now the major export market for almost all Asian states—Korea, Singapore, the Philippines, perhaps soon Japan—and Chinese exports have begun to displace light manufactures from Korea, Taiwan and the ASEAN states in the American market.

The phenomenon is natural and not to be reversed. It does, however, pose some difficult questions. Apart from the North Korean situation which has its own roots, residual tensions in Northeast Asia, especially those still present between Japan and China, can lead to unhealthy competition for influence and markets. Lower-and middle-income Asian states are worried about their eroding shares of the American market, despite their export growth to China, since Americans remain the principal buyers of light manufacturing products which are often very important job creators. And the least-developed Asian states, such as Cambodia and Bangladesh, seem to be getting relatively little benefit from exports to China while being squeezed hard in the American clothing market.

One result has been a scramble for agreements between ASEAN countries, ASEAN countries and major economies, and between major economies themselves, that are creating the potential for an extremely complex trade environment—a spaghetti bowl of agreements in Professor Jagdish Bhagwati's phrase. These agreements must be carefully managed lest they create trade diversion and extra costs, rather than trade creation and lower costs, especially during a period in which WTO negotiations are stalemated, and they may unintentionally contribute to broader political tensions as time passes. To be sure, such agreements may be advantageous in alliance-building terms; economically, their soundness and wisdom remain to be seen absent a more inclusive strategy.

U.S.-China Bilateral Trade Relations

The second key ripple effect runs across the Pacific Ocean. The United States continues to be China's most important trading partner; Sino-American trade has roughly tripled since WTO membership. While our data do not exactly tally with Chinese figures, the trends it reveals are about the same: U.S. exports to China have grown from \$18 billion in 2001 to perhaps \$60 billion; U.S. imports, from \$100 billion in 2001 to nearly \$300 billion this year.

This is an enormous volume of trade involving very large sums of money. The \$300 billion in imports compares to about \$1.5 trillion in American manufacturing value-added production. Even the United States, a \$12 or \$13 trillion economy, cannot accommodate \$200 billion in import growth in five years without some stress and anxiety. You see the social adjustment in the fact that our manufacturing employment has fallen from 17 to 14 million since 2000 (though the factories in question produce more now than they did then); and the tensions are accentuated by the rise in our trade and current-account deficits since 2000, coupled more recently with a rapid rise in China's surpluses.

The result is a very heated and volatile debate over Sino-American trade in Congress. It has gone on for about three years, in various forms. Sometimes the focus centers on implementation of China's WTO commitments, with persistently high rates of counterfeiting and copyright piracy often seen not only as commercial and public-health-and-safety problems in their own right, but as indicators of a failure in implementation. Sometimes the debate generates proposals for penalty tariffs in response to disputes over currency or labor questions. And sometimes, the focus on China is a cause for internal examination about America's own competitive strengths and weaknesses.

Debates over trade relations with China are underway in most of the major economies, sometimes paralleling the themes that arise in the United States and sometimes focusing on other matters:

- Europe has similar worries about competitiveness, highlighted by the EU's recent clothing and shoe import restrictions, and a growing concern about Europe's global economic positioning;

- Japan's concerns often tend to be more strategic, revolving around the Japanese place in Asian markets and the long-term political relationship between Asia's two leading economies.

- India is finding its own niche, examining how to keep up with Chinese industrial growth but also capitalizing on its own strengths in technology, English-language proficiency, and the world services markets.

- And Russia, using oil as its trump card, seeks to balance an eastern and western orientation.

But nowhere is the China trade debate as volatile or passionate as in the U.S., and this ripple effect of China's reemergence will not abate anytime soon, as we will see both before and after the 2006 and 2008 U.S. elections.

Commodities and China's Developing Country Partners

The third ripple effect of China's reemergence is felt in commodity markets—the impact of China's development on both commodity-rich developing countries and commodity-consuming nations. Chinese industrial demand has created metals-and energy-based export booms in Africa, the Middle East, South America and Russia. Chinese aluminum use rose from three to seven million tons between 1999 and 2005; China's oil consumption is still far

behind ours in America, but now ranks second in the world and will soon equal that of Japan and Germany combined. Over the past six years, the prices of almost all major commodities have soared—oil from \$20 to \$60 per barrel, copper from eighty cents to \$1.63 per pound, lead from \$0.23 to \$0.43, and so on.

The effects on commodity suppliers are large and not always entirely positive. Some countries in these regions, especially Africa and the Middle East, have been too reliant on oil and metals exports. While commodity trade generates lots of money, which if used well can be a powerful spur to development and growth, the trade flows are volatile—boom and bust—the industries provide fewer jobs than manufacturing or agriculture, and the wealth earned is filtered through very small numbers of people. Downstream commodity users in developed countries, faced with rising prices for their inputs and fears of long-term constrained supplies, face new competitive pressures. There is as yet no clearly defined policy agenda for governments flowing from changed commodity markets, but such change is an important and inevitable effect of China's reemergence (with India to follow), which will continue to have both positive and negative implications worldwide.

Global Economy

The sum of these phenomena has led to some visible effects on the world economy generally. Many are quite positive, of course. Growth rates have been strong as consumer demand in the U.S. and industrial demand in China combine to pull most of the world along. World unemployment rates, as measured by the ILO, are lower in most parts of the world than they were during the 1990s. But there are also some trends that require careful thought and decisive action. Here are two of them, among many that we could discuss.

Imbalances: One is that the patterns of growth in the U.S. and China reinforce one another's risky tendencies. China has relied on exports rather than domestic demand for employment and growth, with extraordinarily high savings rates to provide capital, and a relatively inflexible currency to bolster competitiveness. The United States, by contrast, has very low savings rates, high consumption, and is an outsized importer.

The combination has fueled a rapid inflation of imbalances, to levels with little historic precedent. The American trade deficit, measured in trade or current-account terms, has risen from around \$300 billion in 2000 to nearly \$800 billion in 2005, and will be larger again this year. China has developed a large surplus, while the surpluses of Japan and some other Asian countries have persisted as well. The risks intensify one another: the U.S. relies on Asia's willingness to cover our budget deficit and shopping bills; Asia in general and China in particular mirror the U.S. vulnerabilities, relying on American shoppers and low interest rates for jobs and growth.

Should this lead to a financial shock, the results might be considerably worse than that of the 1997–99 crisis. America could go into deep recession; Asia's export markets would begin to collapse and Asian employment suffer severely. The world's path to recovery is not clear at all: neither Europe nor Japan, let alone Africa and the Middle East, appears likely to step in as an export market strong enough to preserve growth; and India will remain unable to fill the role for at least a decade or so.

Doha and the WTO: Meanwhile, the WTO has remained stalemated five years into its effort to complete the Doha Development Agenda initiated in 2001. The issues that have brought about the deadlock are familiar: rich-country farm subsidies and agricultural tariffs, plus the responsibilities of large and fast-growing developing countries to further liberalize their economies. None of the big WTO members have thus far been willing to take a dramatic step to break the deadlock, or alternatively all are worried that the others might not match steps they are theoretically willing to take. China, as one of the world's three largest exporters—the single big country most dependent on export-led growth—and the most obvious target of protective policies if respect for WTO rules erodes, obviously has a large stake in the organization's success and the continued respect for its rules.

The Agenda For Governments

The current landscape can thus be loosely described by three characteristics:

- A positive immediate environment, with low unemployment and rapid economic growth in most of the major economies.

- A successful (if admittedly incomplete and sometimes flawed) system of rules and institutions to manage disputes and keep markets open.

—Some dangerous risks: high imbalances, volatile commodity prices and rapidly rising oil demand, deteriorating political conditions in the Middle East (and perhaps the Korean peninsula), Sino-American trade frictions paralleled in part by trade frictions between China and some of its other partners, and a scramble for markets and influence in Asia.

What does all this suggest for governments, as they consider their own responsibilities and priorities? Governments, of course, have only a limited space to deal with international economic matters. But they should not aim too low; they can manage a lot when they choose to. Let me suggest several priorities.

First, governments need to address global imbalances. A financial shock to the United States would obviously produce an echoing shock in Asia, and therefore everywhere in the world. That is a very unpleasant scenario, with no parallels since the 1930s. The best time to reduce the risk is a moment like the present, in which all the major economies are growing. The recipe for this is not all that controversial—most financial thinkers suggest an effort in the United States to reduce its structural budget deficit and raise household savings rates; encouragement of domestic demand-led growth and currency flexibility in China and East Asia; coupled with deregulatory reforms in Europe and Japan.

As a part of this activity, international economic institutions need to reflect China's global economic weight. China's role in the IMF should be enhanced—indeed, steps were taken in this direction at the September Fund meeting in Singapore—and China and the G-8 should discuss the desirability of China joining that group. These institutions, which should have an important role in addressing global imbalances, need China's active participation.

Second, the major economies need to ensure the health of the global trading system. This means completing China's integration into the WTO, and it means ensuring that there is a negotiating path for the future, so that the system moves forward and not backwards. A few words on each.

China is now moving to the last phase of implementation of its WTO commitments, principally services liberalization. These commitments are complex and need attention if they are to be implemented successfully. Meanwhile, disputes have emerged in some areas; this is not unusual—China has been the target of two cases since 2001—the United States, 36 cases—and the system can address all these WTO cases on their merits.

But it is particularly important, at a moment in which Chinese trade growth is somewhat disruptive, to address shortcomings in implementation as quickly and efficiently as possible. If this does not happen, complaints can easily grow from disputes over specific issues into large-scale assaults on trade relationships that the WTO is incapable of resolving.

Regarding the health of the global system, governments need to work on revitalizing the WTO's role as a negotiating forum—either through completion of the Doha talks or a shift of priorities. From a distance, the gaps in the Doha talks should not be utterly impossible to close. Director-General Lamy and others have made reasonable suggestions on how it might be done. But if it cannot be done, we should ask ourselves whether reform of trillions of dollars in manufacturing and services trade must permanently depend on reform of the two percent of global GDP represented by farm trade—and perhaps decide that it is time for something different.

One logical alternative is the revival of the APEC efforts to lower trade barriers in the Pacific. This would have the benefit of reducing complexity and great-power competition within Asia, as well as catalyzing the WTO. A second alternative—complementary to the first—is to use the WTO as a forum for continuous negotiation of both plurilateral and sectoral agreements in areas where trade levels are robust, or policy problems important, but obstacles to success lower than in agriculture. Relevant models include the Information Technology Agreement, the global telecommunications agreement or the global financial services agreement, all of the mid-to-late 1990s, and all a part of the WTO system. Possibilities might include:—Technology: Broadening and improvement of the Information Technology Agreement, beyond computers and telecom equipment to a new set of technologies and goods.

—Automotive trade: including tariffs, quotas and investment policy.

—Energy and the environment: including disciplining subsidies for natural resource industries, elimination of tariffs on environmentally beneficial technologies and energy equipment, and liberalization of environmental services; or

—With respect to least-developed countries, abolition of tariffs and quotas, by all the major economies, on the farm products and the light-industry goods produced in the world's 50 poorest nations.

Third, the leading members of the WTO system need to bring the outsiders into the system. This means completing Russia's WTO accession on commercially meaningful terms. It also means addressing the most

destabilizing gap in the international trading system—the Middle East. The region's isolation—its reliance on oil alone, the absence of manufacturing trade and direct investment, its basic failure to develop—is the global economic system's greatest single failure.

Much of the Muslim world—ten Arab League members, four of the five Central Asian states, Iran, Azerbaijan—remains outside the system. Without the catalyst of WTO membership, they remain unable or unwilling to aggressively pursue needed internal economic reform and diversification. The effect is an economic pattern reminiscent of the 1930s in Asia and Europe. With a tenth of the world's population, the greater Middle East accounts for barely one one-hundredth of world farm and manufacturing exports, and attracts no more direct investment than small countries like Ireland or Singapore. Its unemployment rates are double the world average. This is precisely the sort of economic structure—above all, when laced into the region's political tensions and ideologies—that produces rage and violence.

The solutions, of course, are ultimately within the region. But the problem is everyone's, and the major economies can at least help to solve it. The WTO should give much higher priority to encouraging the countries outside to join, on reasonable terms. The big economies—the United States, Japan, Europe and China—should lead in this effort and, at the same time, examine their own trade policies, eliminating those that pose special difficulties for the region.

Finally, governments need to ensure a peaceful and secure East Asia, which depends in large part on a strong U.S.-China relationship. The international trading system was designed as an adjunct to peace and a catalyst for longer-term stability and prosperity. But so too are stability and peace necessary to the health of the international trading system and the maximization of economic benefits from that system on a global and national basis. This suggests that a top priority of our two governments must be to strengthen and deepen the U.S.-China relationship.

Conclusion

This list—a sampling of actions to which China is now key—is ambitious, but not impossible. Success would leave the world more stable, more inclusive, and of course more able to manage the disruptive aspects of China's reemergence than it is today. Indeed, success would give us a better chance to achieve the ideals that are the themes of this Forum: the Harmony of Civilizations and Prosperity for All.

And with China as a member and manager of the global system rather than an outsider looking in, we have all the more reason to think big and aim high.

Thank you very much.